



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY

Internal Revenue Service
TE/GE EO Examinations
1500 Ormsby Station Court Suite A - Stop 700
Louisville, KY 40223

Release Number: **200840050**

Release Date: 10/3/08

UIL Code: 501.19-01

ORG

ADDRESS

Date: 7/10/08

Taxpayer Identification Number:

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear

We have enclosed a copy of our report of examination explaining why we believe an adjustment of your organization's exempt status is necessary.

If you do not agree with our position you may appeal your case. The enclosed Publication 3498, *The Examination Process*, explains how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

If you request a conference, we will forward your written statement of protest to the Appeals Office and they will contact you. For your convenience, an envelope is enclosed.

If you and Appeals do not agree on some or all of the issues after your Appeals conference, or if you do not request an Appeals conference, you may file suit in United States Tax Court, the United States Court of Federal Claims, or United States District Court, after satisfying procedural and jurisdictional requirements as described in Publication 3498.

You may also request that we refer this matter for technical advice as explained in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*. If a determination letter is issued to you based on technical advice, no further administrative appeal is available to you within the IRS on the issue that was the subject of the technical advice.

If you accept our findings, please sign and return the enclosed Form 6018, *Consent to Proposed Adverse Action*. We will then send you a final letter modifying or revoking exempt status. If we do not hear from you within 30 days from the date of this letter, we will process your case on the basis of the recommendations shown in the report of examination and this letter will become final. In that event, you will be required to file Federal income tax returns for the tax period(s) shown above. File these returns with the Ogden Service Center within 60 days from the date of this letter, unless a request for an extension of time is granted. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Marsha A. Ramirez, Director
Exempt Organizations Examinations

Enclosures:
Publication 892
Publication 3498
Form 6018
Report of Examination
Envelope

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG		Year/Period Ended 20XX

LEGEND

ORG = Organization name Xx = Date motto = motto CO-1 & CO-2 = 1st & 2nd companies.

Issue:

1. Whether the ORG (ORG) sale of pull-tabs results in its being liable for the gambling excise taxes under sections 4401 and 4411 of the Code.

Facts:

From January 1, 20XX – December 31, 20XX ORG conducted weekly motto session that were open to the public.

Gross income reported on the quarterly reports that were filed with the Office of Charitable Gaming was as follows:

	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter	Total
Income					
Motto					
Pull-tabs					
Special					
Checks					
Total Income					

During 20XX, ORG wrote checks from their charitable gaming bank account totaling \$ to ORG used to funds to help pay for their building.

Date	Check Number	Amount
3/22/20XX		
5/1/20XX		
5/1/20XX		
5/10/20XX		
10/24/20XX		
12/6/20XX		
Total		

ORG never filed any tax return since 19XX06. In that year a Form 990 was filed.

ORG did not file any Forms 730 or 11-C.

Law:

Section 4401(a) of the Code imposes (1) on any wager authorized under state law a tax equal to 0.25 percent of the amount wagered and (2) on any wager not authorized under state law a tax equal to 2 percent of the amount wagered.

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ORG		20XX

Section 4411(a) of the Code imposes a special tax of \$500 per year to be paid by each person who is liable for the tax imposed under section 4401 or who is engaged in receiving wagers for or on behalf of any person so liable.

Section 4411(b) of the Code substitutes \$50 for \$500 in subsection (a) in the case of (1) any person whose liability for tax under section 4401 is determined only under paragraph (1) of section 4401(a) and (2) any person who is engaged in receiving wagers only for or on behalf of persons described in paragraph (1).

Section 4421 of the Code provides that wagers include lotteries conducted for profit, but section 4421(2)(B) excludes from the term "lottery" any drawing conducted by an organization exempt from tax under sections 501 and 521, if no part of the net proceeds derived from such drawing inures to the benefit of any private shareholder or individual.

Taxpayer's position:

The taxpayer's position is unknown.

Government's position:

ORG is liable for gambling excise taxes under sections 4401 and 4411 of the Code. Funds from the public sale of pull-tabs inured to the private benefit ORG.

Amounts wagered in drawings conducted by exempt organizations are not subject to wagering tax as long as no part of the net proceeds inures to the benefit of any private shareholder or individual. Generally under the rationale of *Knights of Columbus Council #3660 v. United States*, 783 F.2d 69 (7th Cir. 1986), raising substantial revenue from wagering activities open to the public for a long period of time to defray organizational operating expenses and to subsidize membership, recreational, and social activities constitutes private inurement. If the wagering activities are not open to the public, but are limited to members and bona fide guests, the use of the proceeds to defray operating expenses, etc. does not constitute inurement. Also see *Rochester Liederkrantz v. United States*, 456 F.2d 152 (2d Cir. 1972).

To sustain an assertion of tax, the facts must show the source and disposition of the net proceeds from wagering. For example, if it is shown that wagers were accepted from nonmember/guest sources, the wagering proceeds were commingled with other bar or motto revenue, and those proceeds were applied in part for general operating expenses or to subsidize the bar and food operations and in part for charitable purposes, a proportionate amount of the wagering proceeds could be deemed to have inured to the benefit of the members. If, on the other hand, the wagering revenue is separately accounted and is earmarked solely for charitable purposes, no inurement can be attributed to the wagering activities and no liability for tax arises.

Conclusion:

Based upon the above, ORG has not met the exception of section 4421 of the Code, as it has not shown that funds were not spent for operating expenses. ORG has not shown that inurement did not occur.

To reduce the burden on the taxpayer, Forms 730 and 11-C have been prepared by the government.

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer		Year/Period Ended
ORG		August 31, 20XX - 20XX

LEGEND

ORG = Organization name XX = Date

Issue:

Whether ORG (ORG) qualifies for exemption under Section 501(c)(19) of the Internal Revenue Code.

Facts:

Exhibit A provides copies of the Internal Revenue Service correspondence requesting that ORG file the Form 990 for the tax periods ending August 31, 20XX - 20XX.

ORG failed to respond to the Internal Revenue Service correspondence or file the Form 990 for the tax periods ending August 31, 20XX – 20XX.

Law:

Section 6001 of the Code provides that every person liable for any tax imposed by the Code, or for the collection thereof, shall keep adequate records as the Secretary of the Treasury or his delegate may from time to time prescribe.

Section 6033(a)(1) of the Code provides, except as provided in section 6033(a)(2), every organization exempt from tax under section 501(a) shall file an annual return, stating specifically the items of gross income, receipts and disbursements, and such other information for the purposes of carrying out the internal revenue laws as the Secretary may by forms or regulations prescribe, and keep such records, render under oath such statements, make such other returns, and comply with such rules and regulations as the Secretary may from time to time prescribe.

Section 1.6001-1(a) of the regulations in conjunction with section 1.6001-1(c) provides that every organization exempt from tax under section 501(a) of the Code and subject to the tax imposed by section 511 on its unrelated business income must keep such permanent books or accounts or records, including inventories, as are sufficient to establish the amount of gross income, deduction, credits, or other matters required to be shown by such person in any return of such tax. Such organization shall also keep such books and records as are required to substantiate the information required by section 6033.

Section 1.6001-1(e) of the regulations states that the books or records required by this section shall be kept at all times available for inspection by authorized internal revenue officers or employees, and shall be retained as long as the contents thereof may be material in the administration of any internal revenue law.

Section 1.6033-1(h)(2) of the regulations provides that every organization which has established its right to exemption from tax, whether or not it is required to file an annual return of information, shall submit such additional information as may be required by the district director for the purpose of enabling him to inquire further into its exempt status and to administer the provisions of subchapter F (section 501 and the following), chapter 1 of the Code and section 6033.

Rev. Rul. 59-95, 1959-1 C.B. 627, concerns an exempt organization that was requested to produce a financial statement and statement of its operations for a certain year. However, its records were so incomplete that the organization was unable to furnish such statements. The Service held that the failure or inability to file the required information return or otherwise to comply with the provisions of section 6033 of the Code and the regulations which implement it, may result in the termination of the exempt status of

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ORG		August 31, 20XX - 20XX

an organization previously held exempt, on the grounds that the organization has not established that it is observing the conditions required for the continuation of exempt status.

In accordance with the above cited provisions of the Code and regulations under sections 6001 and 6033, organizations recognized as exempt from federal income tax must meet certain reporting requirements. These requirements relate to the filing of a complete and accurate annual information (and other required federal tax forms) and the retention of records sufficient to determine whether such entity is operated for the purposes for which it was granted tax-exempt status and to determine its liability for any unrelated business income tax.

Taxpayer's Position:

The taxpayer failed to file the required Form 990s.

Government's Position:

The tax exempt status of ORG should be revoked effective September 1, 20XX

Conclusion:

It is the IRS's position that ORG failed to meet the reporting requirements under sections 6001 and 6033 to be recognized as exempt from federal income tax under 501(c)(19) of the Internal Revenue Code. Accordingly, ORG's exempt status is revoked effective September 1, 20XX.

Forms 1120 tax returns should be filed for all tax periods after September 1, 20XX.